INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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Index (UIL) No.: 936.09-00
CASE-MIS No.: TAM-131959-08

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No
Year(s) Involved:
Date of Conference:

LEGEND:

Taxpayer	=
USCorp	=
FCorp	=
Taxable Year 1	=
Taxable Year 2	=
Taxable Year 3	=
Taxable Year 4	=
Date 1	=
Date 2	=
LLC 1	=
LLC 2	=
LLC 3	=
Division 1	=

Division 2	=
Division 3	=
Amount A	=
Amount B	=
Amount C	=
Amount D	=
Amount E	=
Amount F	=
Amount G	=

ISSUE:

Whether section 936(j)(5)(D) requires a corporation claiming the section 936 possession tax credit to adjust its adjusted base period income upon the transfer of a major portion of a trade or business or major portion of a separate unit of a trade or business to an affiliated foreign corporation?

CONCLUSION:

Yes. Section 936(j)(5)(D) provides that rules similar to the rules of section 41(f)(3)(A) and (B) apply for purposes of section 936(j). Applying rules similar to the rules of section 41(f)(3)(A) and (B) for purposes of section 936 requires a disposing corporation to adjust its adjusted base period income whenever there is a disposition of a major portion of a trade or business or major portion of a separate unit of a trade or business to an affiliated foreign corporation.[1]

FACTS:

USCorp conducted various manufacturing operations in Puerto Rico through subsidiary domestic corporations (including Taxpayer) that elected the application of section 936 to claim the Puerto Rico and possession tax credit ("possession tax credit" or "section 936 credit"). Taxpayer's manufacturing operations included, but were not limited to, Division 1, Division 2, and Division 3. On Date 1, Taxpayer transferred all of the operating assets of Division 1 to LLC 1, certain of the assets of Division 2 to LLC 2, and all of the operating assets of Division 3 to LLC 3 in exchange for shares in those limited liability companies.

On Date 1, immediately after the transfers of the assets to LLC 1, LLC 2, and LLC 3, Taxpayer transferred all of its shares in LLC 1 and LLC 2 and its class B shares in LLC 3 to FCorp, a newly formed foreign corporation, in exchange for stock in FCorp. Neither LLC 1, LLC 2, LLC 3, nor FCorp elected its entity classification. As a result,

[1] This TAM only addresses the factual scenario provided to us, which involves an affiliated foreign corporation acquiring a major portion of a trade or business or major portion of a separate unit of a trade or business from Taxpayer. Nothing in this TAM is intended to imply that we would reach a different conclusion if the acquiring corporation were a domestic corporation.

LLC 1 and LLC 2 were each treated as disregarded entities, and LLC 3 was treated as a disregarded entity prior to the transfer of its class B shares to FCorp and as a partnership after such transfer. On its returns, Taxpayer treats FCorp as a wholly owned controlled foreign corporation.

Beginning with its Taxable Year 1, Taxpayer elected to apply the applicable percentage limitation method provided in section 936(a)(4)(B) for purposes of computing the amount of its possession tax credit under section 936. For purposes of section 936(j), Taxpayer elected to use its base period income for 1995 as provided in section 936(j)(5)(C)(i)(II) and (ii).

Taxpayer calculated its aggregate taxable income on its original return for Taxable Year 3 as Amount A and for Taxable Year 4 as Amount B. Taxpayer calculated its adjusted base period income on its original return for Taxable Year 3 as Amount C and for Taxable Year 4 as Amount D. As a result, on Taxpayer's original returns for Taxable Year 3 and Taxable Year 4, Taxpayer's adjusted base period income limited the amount of taxable income Taxpayer could use to compute its possession tax credit by Amount E and Amount F, respectively.

On or around Date 2, Taxpayer filed amended returns for Taxable Year 3 and Taxable Year 4 reporting Amount G as its adjusted base period income. Taxpayer's reason for the recomputed adjusted base period income was that it was not required to reduce its adjusted base period income based upon the disposition of the assets of Division 1, Division 2, and Division 3. As a result, Taxpayer's adjusted base period income on its amended returns for Taxable Year 3 and Taxable Year 4 did not limit the amount of taxable income Taxpayer could use to compute the possession tax credit.

LAW:

A. Section 936

Section 936(a) and (e) provide for an election for a corporation meeting certain criteria to be treated as a possession corporation under section 936. Section 936(a) provides a credit against U.S. income tax in an amount equal to tax attributed to non-U.S. source taxable income from the active conduct of a trade or business within a U.S. possession, provided the domestic corporation derives at least 80% of its gross income for a preceding three-year period from sources within a U.S. possession, and at least 75% of such gross income is derived from the active conduct of a trade or business in a U.S. possession. I.R.C. § 936(a)(2).

In 1993, Congress enacted section 936(a)(4) to limit the amount of the section 936 credit because it was concerned that the section 936 credit was not effectively promoting economic development in Puerto Rico with respect to certain industries that derived a large amount of taxable income from using intangible assets. In expressing this concern, the House of Representatives Budget Committee report provides:

> [P]ast studies have indicated that a disproportionate share of the tax benefits attributable to section 936 is realized by certain industries that created relatively few jobs in the possessions [citing the *Pharmaceutical Industry – Tax Benefits of Operating in Puerto Rico*, United States General Accounting Office Briefing Report, to the Chairman on Aging, U.S. Senate, GAO/ GGD-92-72-BR, Appendix I, Tables I.1 and I.2, pp. 12-14]. These industries tend to be those for which a large portion of taxable income is derived from the use of intangible assets (e.g., exploitation of patents, tradenames, or secret formulas). The committee is concerned, moreover, that a disproportionate share of the cost that all U.S. taxpayers bear in order to provide the section 936 credit may have inured to the benefit of the stockholders of the possession corporations, as compared to the U.S. citizens residing in the possessions. To address this concern without hurting the people for whose benefit the credit was adopted, the committee believes that a better approach would be to place a limit on the tax benefit available to a possession corporation attributable to its active business operations in the possessions, and to base that limit on a measure of the employment created by the corporation in the possession.

H.R. Rep. No. 111, 103d Cong., 1st Sess. 676 (1993).

Section 936(a)(4) provides two methods to limit the section 936 credit. Section 936(a)(4)(A) provides the economic activity limitation method, which limits the section 936 credit based on certain percentages of qualified wages, fringe benefit expenses, and depreciation allowances and, in some cases, the amount of qualified possession income taxes for the taxable year allocable to nonsheltered income. Section 936(a)(4)(B) gives taxpayers the option of electing to apply the applicable percentage limitation method in place of the economic activity limitation method. The applicable percentage limitation method limits the section 936 credit to a particular percentage of the section 936 credit that would have been available under section 936(a)(1).

Despite the limitations imposed in section 936(a)(4), Congress determined that the possession tax credit no longer provided an appropriate incentive for investment and economic development in Puerto Rico because the tax benefits from the possession tax credit accrued to a relatively small number of U.S. corporations operating in U.S. possessions and the tax costs associated with these credits were borne by all U.S. taxpayers. <u>See</u> H.R. Rep. No. 586, 104th Cong., 2d Sess. 131 (1996); S. Rep. No. 281, 104th Cong., 2d Sess. 109 (1996). As a result, Congress enacted section 1601 of the Small Business Job Protection Act of 1996 (Pub. L. No. 104-188, 110 Stat. 1755, 1827 (1996)), which generally repealed the possession tax credit for taxable years beginning after December 31, 1995. However, Congress also provided a transition period to allow corporations with existing operations in the possessions to modify their business operations in view of the eventual repeal of the possession tax credit. <u>Id.</u> These transition rules, provided in section 936(j), permit a corporation that was an existing credit claimant to claim credits during a phase-out period consisting of taxable years beginning after December 31, 1995, and before January 1, 2006.

An “existing credit claimant” is defined in section 936(j)(9)(A) as a corporation –

> (i)(I) which was actively conducting a trade or business in a possession on October 13, 1995, and
> (II) with respect to which an election under this section is in effect for the corporation's taxable year which includes October 13, 1995, or
>
> (ii) which acquired all of the assets of a trade or business of a corporation which—
> (I) satisfied the requirements of subclause (I) of clause (i) with respect to such trade or business, and
> (II) satisfied the requirements of subclause (II) of clause (i).

If an existing credit claimant computes its possession tax credit using the applicable percentage limitation method under section 936(a)(4)(B), then for taxable years beginning after December 31, 1997, the amount of the existing credit claimant’s possession business income that is eligible for the possession tax credit cannot exceed the “adjusted base period income” of the claimant. <u>See</u> I.R.C. § 936(j)(3). If an existing credit claimant computes its possession tax credit using the economic activity limitation method under section 936(a)(4)(A), then for taxable years beginning after December 31, 2001, the amount of the existing credit claimant’s possession business income that is eligible for the possession tax credit cannot exceed the adjusted base period income of the claimant. <u>Id.</u> The adjusted base period income serves as a cap that may limit the amount of credits available during part of the phase-out period. <u>See</u> I.R.C. § 936(j)(4).

The adjusted base period income is generally computed as the average of the inflation-adjusted possession income of the possession corporation for each base period year. The possession corporation’s base period years generally are three of the possession corporation’s five most recent taxable years ending before October 14, 1995, determined by disregarding the taxable years in which the adjusted base period incomes were largest and smallest. I.R.C. § 936(j)(5)(A). Section 936(j)(5)(C) gives taxpayers the option of electing to use one base period year, which was either the last taxable year of the possession corporation ending in 1992 or a deemed taxable year that includes the first ten months of 1995. If a taxpayer elected the deemed taxable year that includes the first ten months of 1995, the possession income for those ten months must be annualized without regard to any extraordinary item.

In the case of an acquisition or disposition, section 936(j)(5)(D) provides that "[r]ules similar to the rules of subparagraphs (A) and (B) of section 41(f)(3) shall apply for purposes of" section 936(j) – in particular, for purposes of computing an existing credit claimant's adjusted base period income. In discussing the computation of adjusted base period income, the report prepared by the Joint Committee on Taxation provides:

> Adjustments to the corporation's average adjusted base period possession business income to reflect acquisitions and dispositions shall be made under rules similar to the rules of section 41(f)(3). Under section 41(f)(3), adjustments are made upon the acquisition or disposition of the major portion of a trade or business or the major portion of a separate unit of a trade or business.

Joint Committee on Taxation Staff, General Explanation of Tax Legislation Enacted in the 104th Congress, 104th Cong., 210 (1996). Congress also briefly discussed adjustments to adjusted base period income in the legislative history of section 936(j)(9). In that context, Congress stated:

> [A] corporation that acquires all the assets of a trade or business of an existing credit claimant will qualify as an existing credit claimant. The adjusted base period income of the existing credit claimant from which the assets are acquired is divided between such corporation and the corporation that acquires such assets. It is intended that regulations or other guidance will prevent taxpayers from abusing this rule through transactions that manipulate base period income amounts.

H.R. Conf. Rep. No. 737, 104th Cong., 2d Sess. 292 (1996).

B. Section 41(f)(3)(A) and (B)

Section 41 provides rules for computing tax credits for certain increases in research expenditures. In general, section 41(a) provides that the research credit equals the sum of: (1) 20 percent of the excess of qualified research expense for the tax year over the base amount, (2) 20 percent of the basic research payments determined under section 41(e)(1)(A), and (3) 20 percent of the amounts paid or incurred by the taxpayer in carrying on any trade or business of the taxpayer during the taxable year to an energy research consortium. The base amount equals the product of the fixed-base percentage and the average annual gross receipts of the taxpayer for the four taxable years preceding the taxable year for which the credit is being determined. I.R.C. § 41(c)(1). In general, the fixed-base percentage is a percentage determined by dividing the total qualified research expenses of the taxpayer for taxable years beginning after December 31, 1983, and before January 1, 1989, by the total gross receipts of the taxpayer for that same period. I.R.C. § 41(c)(3)(A).[2] Because the credit is based on a taxpayer's increases in research expenditures by reference to research expenditures in prior periods, the computation of the section 41 credit is based in part on the amount of qualified research expenses that exceeds a base amount. In this context, the base amount serves as a floor for purposes of computing tax credits for research expenditures. See I.R.C. § 41(c).

Section 41(f)(3) provides certain rules for adjusting qualified research expenses and gross receipts for purposes of computing the section 41 research credit if there is an acquisition or a disposition of a major portion of a trade or business or major portion of a separate unit of a trade or business. Solely for purposes of brevity and readability, we generally refer to a major portion of a trade or business or major portion of a separate unit of a trade or business as a "major portion" throughout the remainder of this memorandum. Section 41(f)(3)(A)[3] provides that if:

> a taxpayer acquires the major portion of a trade or business of another person (hereinafter in this paragraph referred to as the "predecessor") or the major portion of a separate unit of a trade or business of a predecessor, then, for purposes of applying this section for any taxable year ending after such acquisition, the amount of qualified research expenses paid or incurred by the taxpayer during periods before such acquisition shall be increased

[2] When enacted as section 221 of the Economic Recovery Tax Act of 1981 (Pub. L. No. 97-34, 95 Stat. 172, 241 (1981)), the general rule provided that the research credit equaled 25 percent of the excess of the qualified research expenses for the taxable year over the base period research expenses. Generally, the base period research expenses equaled the average of the qualified research expenses for the three taxable years immediately preceding the taxable year for which the determination was being made. In 1989, Congress amended section 41 in section 7110 of the Omnibus Budget Reconciliation Act of 1989 (Pub. L. No. 101-239, 103 Stat. 2322, 2324 (1989)) to provide that the computation of the section 41 credit would be based, in part, on the taxpayer's historic gross receipts. The House Report states that Congress added gross receipts to the computation of the section 41 research credit because it would enhance the credit's incentive effect by indexing taxpayers' "base amount to average growth in its gross receipts" and "indexing the credit for inflation." H.R. Rep. No. 247, 101st Cong., 1st Sess. 1199-1200 (1989).

[3] Section 7110 of the Omnibus Budget Reconciliation Act of 1989 (Pub. L. No. 101-239, 103 Stat. 2322, 2324 (1989)) also amended sections 41(f)(3)(A) and (B) to require adjustments to gross receipts.

> by so much of such expenses paid or incurred by the predecessor with respect to the acquired trade or business as is attributable to the portion of such trade or business or separate unit acquired by the taxpayer, and the gross receipts of the taxpayer for such periods shall be increased by so much of the gross receipts of such predecessor with respect to the acquired trade or business as is attributable to such portion.

Further, section 41(f)(3)(B) provides that if:

> (i) a taxpayer disposes of the major portion of any trade or business or the major portion of a separate unit of a trade or business in a transaction to which subparagraph (A) applies, and
>
> (ii) the taxpayer furnished the acquiring person such information as is necessary for the application of subparagraph (A),
>
> then, for purposes of applying this section for any taxable year ending after such disposition, the amount of qualified research expenses paid or incurred by the taxpayer during periods before such disposition shall be decreased by so much of such expenses as is attributable to the portion of such trade or business or separate unit disposed of by the taxpayer, and the gross receipts of the taxpayer for such periods shall be decreased by so much of the gross receipts as is attributable to such portion.

Treas. Reg. § 1.41-7(b) provides that "[f]or the meaning of 'acquisition,' 'separate unit,' and 'major portion,' see paragraph (b) of § 1.52-2. An 'acquisition' includes an incorporation or liquidation."

The 1981 predecessor statute to section 41 (i.e., section 44F)[4] was substantially similar to section 41. The conference agreement to section 44F follows the House Ways and Means Committee Report. H.R. Conf. Rep. No. 215, 97th Cong., 1st Sess. 223 (1981). In its discussion of the rules for changes in business ownership provided in section 44F(f)(3), the House Ways and Means Committee Report provides:

> The provision includes special rules for computing the credit where a business changes hands. These rules

[4] The research credit was originally enacted as I.R.C. § 44F in 1981, redesignated as I.R.C. § 30 in 1984, and redesignated as I.R.C. § 41 in 1986.

are intended to facilitate an accurate computation of base period expenditures and the credit by attributing research expenditures to the appropriate taxpayer. If the provision did not include rules for changes in ownership of a business, a taxpayer who begins business by buying and operating an existing company might be entitled to a credit even if the amount of qualified research expenses were not increased. Also, the sale of a unit of a business could cause the seller to lose any credit even though qualified research expenditures increased in the part of the business that was retained. These rules for changes in business ownership, described below, are to apply under Treasury regulations.

Acquisitions

Under the provision, if a taxpayer acquires (after June 30, 1980) the major portion of a trade or business (or of a separate unit thereof), the credit for any year ending after the acquisition is to be computed as if the business had not changed hands. That is, the taxpayer's qualified research expenditures for periods before the acquisition are to be increased by the amount of qualified research expenditures attributable to the acquired business (or separate unit).

Under these rules, a taxpayer is not to be treated as acquiring the major portion of a trade or business (or of a separate unit thereof) merely because the taxpayer acquires some assets used in that trade or business. Instead, this determination is to be made on the basis of whether the acquisition involves the transfer of a viable trade or business which can be operated by the taxpayer.

Dispositions

The provision also includes rules for computing the amount of incremental expenditures if a taxpayer disposes (after June 30, 1980) of the major portion of a trade or business (or of a separate unit thereof) in a transaction to which the above acquisition rules apply. In determining the credit allowable to the taxpayer for a taxable year ending after the disposition, the taxpayer's qualified research expenditures

> for periods before the disposition generally are to be decreased by the amount of the taxpayer's qualified research expenditures attributable to the portion of the business (or separate unit) which has changed hands. (This rule permits a taxpayer which operates two businesses to sell one and nevertheless earn a credit for increased research expenditures in the retained business.) This relief is not provided unless the taxpayer furnishes the acquiring person with information needed to compute the credit under the acquisition rules in the preceding paragraph.

H.R. Rep. No. 201, 97th Cong., 1st Sess. 124-125 (1981). The Senate Report provides a similar explanation of this provision. See S. Rep. No. 144, 97th Cong., 1st Sess. 84-85 (1981). In its discussion of the rules for changes in business ownership, the Joint Committee on Taxation Staff explains:

> The Act includes special rules for computing the credit where a business changes hands, under which qualified research expenditures for periods prior to the change of ownership generally are treated as transferred with the trade or business which gave rise to those expenditures. These rules are intended to facilitate an accurate computation of base period expenditures and the credit by attributing research expenditures to the appropriate taxpayer.

Joint Committee on Taxation Staff, General Explanation of the Economic Recovery Act of 1981, 97th Cong., 135 (1981).

The legislative history to Congress' 1989 amendment to section 41, which included gross receipts in the computation of the section 41 credit, explains:

> The rules relating to aggregation of related persons and changes in business ownership are the same as under present law, with the modification that when a business changes hands, qualified research expenses and gross receipts for periods prior to the change of ownership are treated as transferred with the trade or business which gave rise to those expenditures and receipts for purposes of recomputing a taxpayer's fixed base percentage.

H.R. Conf. Rep. No. 386, 101st Cong., 1st Sess. 542 (1989); H.R. Rep. No. 247, 101st Cong., 1st Sess. 1202 (1989).

ANALYSIS:

As explained below in the “Taxpayer’s Position” section, Taxpayer interprets section 936(j)(5)(D) as not requiring it to reduce its adjusted base period income as a result of its transfers to FCorp on Date 1.

For the reasons discussed below in the “Service’s Position” section, we interpret section 936(j)(5)(D) as requiring Taxpayer to reduce its adjusted base period income as a result of its transfers to FCorp on Date 1.

A. Taxpayer’s Position

Taxpayer presents several arguments of varying complexity. We summarize those arguments here. Then, in the “Service’s Position” section, we explain why Taxpayer’s arguments are incorrect.

Argument #1: The Taxpayer Requirement

Step 1: For purposes of section 936(j), section 936(j)(5)(D) requires the application of rules similar to the rules contained in section 41(f)(3)(A) and (B).

Step 2: Section 41(f)(3)(A) provides that a taxpayer that acquires a major portion must increase its qualified research expenses and gross receipts with respect to the amounts attributable to such acquisition. Therefore, an acquiring party is not required to make an adjustment under section 41(f)(3)(A) if it is not a taxpayer as defined in section 7701(a)(14).

Step 3: Section 41(f)(3)(B) provides that a taxpayer that disposes of a major portion “in a transaction to which [section 41(f)(3)(A)] applies” must decrease its qualified research expenses and gross receipts with respect to the amounts attributable to the disposition. Therefore, a disposing party is required to make an adjustment under section 41(f)(3)(B) only if the corresponding acquiring party is a taxpayer as defined in section 7701(a)(14).

Step 4: FCorp was not a taxpayer as defined in section 7701(a)(14) at the time of the acquisitions. Therefore, Taxpayer would not have been required to make an adjustment under section 41(f)(3)(B) had it disposed of a major portion that FCorp acquired.

Step 5: For purposes of section 936(j)(5)(D), adjustments to qualified research expenses and gross receipts under section 41(f)(3) are analogous to adjustments to adjusted base period income under section 936(j). Because Taxpayer would not have been required to make an adjustment under section 41(f)(3)(B) by virtue of FCorp’s taxpayer status, Taxpayer is not required to make an adjustment to its adjusted base period income under section 936(j)(5)(D) by virtue of FCorp’s taxpayer status.

2. Argument #2: The Existing Credit Claimant Requirement

a. Variation 1

Step 1: Section 936(j)(3) allows existing credit claimants to claim credits under section 936(a)(1)(A). The words "existing credit claimant" implicitly indicate that a person covered by that term is permitted to claim credits. Section 936(a)(1)(A) allows credits only to domestic corporations. Therefore, the term "existing credit claimant" does not apply to foreign corporations.

Step 2: The taxpayer concept in section 41(f)(3)(A) is similar to the existing credit claimant concept in section 936(j).[5] Therefore, section 936(j)(5)(D) requires an adjustment for the disposing party only if the acquiring party is an existing credit claimant.

Step 3: Because FCorp is a foreign corporation, it is not an existing credit claimant and, therefore, Taxpayer is not required to make adjustments under section 936(j)(5)(D).

b. Variation 2

Step 1: Section 936(j)(3) allows existing credit claimants to claim credits under section 936(a)(1)(A). The words "existing credit claimant" implicitly indicate that a person covered by that term is permitted to claim credits. Section 936(j)(9)(A)(ii) limits the definition of existing credit claimant to, among other things, a corporation that "acquired all of the assets of a trade or business." Therefore, the term "existing credit claimant" does not apply to a corporation that acquires less than all of the assets of a trade or business.

Step 2: The taxpayer concept in section 41(f)(3)(A) is similar to the existing credit claimant concept in section 936(j).[6] Therefore, section 936(j)(5)(D) requires an adjustment for the disposing party only if the acquiring party is an existing credit claimant.

[5] We have never fully understood this aspect of Taxpayer's argument. On its face, it seems to contradict Taxpayer's Argument #1 by substituting the term "existing credit claimant" for "taxpayer" in section 41(f)(3)(A), thereby, disregarding the term "taxpayer" to which Taxpayer ascribes so much importance. It is possible that Taxpayer intends Argument #2 as an alternate argument with respect to Argument #1. It is also possible that Taxpayer believes they are two stand-alone requirements – (1) the acquiring party must be a taxpayer and (2) the acquiring party must also be an existing credit claimant. Regardless, our analysis below demonstrates that neither argument helps Taxpayer.

[6] See note 5, above.

Step 3: Because FCorp did not acquire all the assets of a trade or business, it is not an existing credit claimant and, therefore, Taxpayer is not required to make adjustments under section 936(j)(5)(D).

3. Argument #3: What's Good for the Goose Is Good for the Gander

Section 41(f)(3)(B) denies adjustments for the disposing party if it merely discontinues a major portion, rather than transfers it. Similarly, section 41(f)(3)(B) denies adjustments for the disposing party if it disposes of something less than a major portion. This demonstrates that it is appropriate not to require adjustments in some situations. Therefore, it is appropriate not to require adjustments in this case. In other words, what's good for the goose is good for the gander (and Taxpayer is the gander).

4. Argument #4: The Anti-abuse Regulation Does Not Apply

In the legislative history, Congress expressed a concern that taxpayers might use acquisitions to abuse the rules under section 936(j)(5)(D). Congress explained: "It is intended that regulations or other guidance will prevent taxpayers from abusing this rule through transactions that manipulate base period amounts." H.R. Conf. Rep. No. 737, 104^{th} Cong., 2d Sess. 292 (1996). Treas. Reg. § 1.936-11(b)(3)(ii)(A) provides rules regarding acquisitions and the qualification of acquiring parties as existing credit claimants. Therefore, a transaction that is subject to section 936(j)(5)(D) is not subject to challenge by the Service if it does not run afoul of Treas. Reg. § 1.936-11(b)(3)(ii)(A). For this purpose, a transaction runs afoul of Treas. Reg. § 1.936-11(b)(3)(ii)(A) if the acquiring party fails to carry on a major portion that it acquired.

B. Service's Position

1. Response to Argument #1

a. Application of Section 41(f)(3)(A) and (B)

Section 41(f)(3)(B)(i) provides that "if… a taxpayer disposes of a major portion of a trade or business… in a transaction to which subparagraph (A) applies" then the disposing party must decrease its qualified research expenses and gross receipts by the amount of those expenses and receipts attributable to the disposed major portion. (Emphasis added.) As explained above, Taxpayer believes that the reference to subparagraph (A) in section 41(f)(3)(B)(i) must be interpreted as prohibiting adjustments under section 41(f)(3)(B) for a disposing party if the acquiring party is not a taxpayer as defined in section 7701(a)(14). Although the issue of whether the acquiring party is a "taxpayer" may be relevant to whether the acquiring party must make adjustments under section 41(f)(3)(A), it does not necessarily follow, and should not follow, that this requirement applies for purposes of section 41(f)(3)(B). We believe the better interpretation, taking into account the purpose and context of the provision, is that it focuses on the occurrence of a disposition of a major portion that is acquired in its entirety by a single party. Therefore, adjustments under section 41(f)(3)(B) are not contingent upon the acquiring party's taxpayer status. Further, in light of our conclusion in the preceding sentence, whether adjustments under section 41(f)(3)(A) are contingent upon the acquiring party's taxpayer status is not relevant to this case.[7]

Our interpretation may be best understood, perhaps, by considering how section 41(f)(3)(B) would function absent the reference to section 41(f)(3)(A). In that scenario, section 41(f)(3)(B) would apply to any person that disposes of a major portion, regardless of whether such major portion is acquired by a single party. For example, if the disposing party were to sell off the entire major portion in pieces to multiple parties, section 41(f)(3)(B) would be satisfied, and the disposing party would be required to make adjustments. But by including the reference to section 41(f)(3)(A) in section 41(f)(3)(B), Congress indicated that such adjustments are warranted only if the major portion is transferred to a single party as a whole, functioning business unit. To put it another way, the reference to section 41(f)(3)(A) is properly understood as ensuring that section 41(f)(3)(B) applies only if a major portion is transferred intact, as opposed to being discontinued or transferred piecemeal. Whether the acquiring party is a taxpayer is irrelevant to that distinction.

Our interpretation of section 41(f)(3)(B) is supported by the legislative history to, and policy underlying, section 41(f)(3). As originally enacted, section 41(f)(3)(B) provided a relief provision so that a party that transferred a major portion was not required to include qualified research expenses attributable to such major portion. As stated in the legislative history of former section 44F:

> These rules are intended to facilitate an accurate computation of base period expenditures and the credit by attributing research expenditures to the appropriate taxpayer. If the provision did not include rules for changes in ownership of a business… the sale of a unit of a business could cause the seller to lose any credit even though qualified research expenditures increased in the part of the business that was retained.

H.R. Rep. No. 201, 97th Cong., 1st Sess. 124-125 (1981). Applying an interpretation of section 41(f)(3)(B) that does not allow the disposing party to make adjustments upon

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[7] The incoming request for technical advice listed ten questions that Taxpayer and the Field wanted answered. Each of those questions is answered in this memorandum. We note here that several of those questions regarded the extent to which adjustments under section 41(f)(3)(B) depend on the taxpayer status of the acquiring party described in section 41(f)(3)(A). As developed in the present discussion, those questions are irrelevant to the case at hand because they are premised on a misinterpretation of section 41(f)(3)(B). Rather, the questions should have focused on the proper interpretation of section 41(f)(3)(B) in the first instance.

the disposition of a major portion to another party would undermine the original purpose for enacting section 41(f)(3)(A) and (B).

Our interpretation of section 41(f)(3)(B) is also consistent with sound and consistent tax administration. If the taxpayer status of the acquiring party were to dictate whether the disposing party must make adjustments under section 41(f)(3)(B), then a party disposing of a major portion would need to know the acquiring party's taxpayer status in order to determine whether an adjustment is required. Section 41 contains no provision requiring the acquiring party to furnish information to the disposing party regarding the acquiring party's taxpayer status, nor has the Service imposed such a requirement in published guidance. Therefore, when the acquiring and disposing parties are unrelated, Taxpayer's interpretation of section 41(f)(3)(B) would leave the disposing party unsure of whether it must adjust its qualified research expenses and gross receipts unless the acquiring party gratuitously notifies the disposing party of its taxpayer status at the time of the transfer. In other words, under Taxpayer's interpretation, the disposing party will in many cases have no way of knowing whether it must make an adjustment in the first place. To put it another way, under Taxpayer's interpretation, section 41(f)(3)(B) discriminates in favor of transfers between related parties. And looking at it from yet another angle, it would be fundamentally unfair to interpret the statute as requiring a disposing party to make an adjustment based on information that the taxpayer is unable to obtain. But under our interpretation, these significant problems simply do not arise.

To our knowledge, this issue of interpreting section 41(f)(3)(B) adversely to taxpayers has not arisen before, and Taxpayer concedes that it cannot cite a single instance where a taxpayer has been denied research credits under the reasoning on which Taxpayer relies in this case. In addition, we believe that our interpretation of section 41(f)(3)(B) is the better interpretation in light of the plain language of section 41(f)(3)(B), the purpose of enacting section 41(f)(3)(A) and (B), and the legislative history to section 41(f)(3). Accordingly, we find no requirement in section 41(f)(3)(B) that an acquiring party must be a taxpayer and, therefore, we see no carryover requirement in section 936(j)(5)(D) that an acquiring party must be a taxpayer in order for an adjustment to be required with respect to a disposing party. However, as discussed immediately below, even if Taxpayer's interpretation of section 41(f)(3)(A) and (B) were correct, such an interpretation does not carry over to section 936(j)(5)(D).

<u>b. Application of Section 936(j)(5)(D)</u>

<u>*Rules "similar" to the rules of section 41(f)(3)(A) and (B)*</u>

Section 936(j)(5)(D) provides that "Rules similar to the rules of subparagraphs (A) and (B) of section 41(f)(3) shall apply for purposes of" section 936(j). So, our mandate, based on the plain language of section 936(j)(5)(D), is to apply rules that are similar to the rules in section 41(f)(3)(A) and (B) to section 936(j). Applying rules "similar" to the rules of section 41(f)(3)(A) and (B) requires application of the rules of section 41(f)(3)(A) and (B) to the extent that those rules are consistent with the plain language of section 936 as informed by the Congressional intent regarding the phase-out and termination provisions of section 936(j). See Flora v. United States, 357 U.S. 63, 65 (1958) ("In matters of statutory construction the duty… is to give effect to the intent of Congress"). A statute should be construed so that all of its words are preserved and given force. See, e.g., Chickasaw Nation v. United States, 534 U.S. 84, 85 (2001). Obviously we cannot apply the rules of section 41(f)(3)(A) and (B) literally or verbatim because section 936(j) does not contain a qualified research expense or gross receipts concept. The one point on which Taxpayer and we seem to agree is that the only way to make sense of section 936(j)(5)(D) is to assume that the adjusted base period income concept in section 936(j) is analogous to the qualified research expense and gross receipts concepts in section 41(f)(3). This view is confirmed by the legislative history. See Joint Committee on Taxation Staff, General Explanation of Tax Legislation Enacted in the 104th Congress, 104th Cong., 210 (1996). But from that point, we part ways.

Section 936(j)(5)(D) does not require that the acquiring party be a taxpayer in order for the disposing party to make adjustments

Applying the "similar rules" standard, section 936(j)(5)(D) requires a party that disposes a major portion to make adjustments to its adjusted base period income if a single party acquires that major portion. Contrary to Taxpayer's assertions, we do not find a taxpayer requirement in section 41(f)(3)(B), so we do not import a taxpayer requirement into section 936(j)(5)(D). Similarly, we do not find or import the concept that an adjustment to the disposing party is contingent upon an adjustment to the acquiring party. Our position is really quite simple – we would require an adjustment to the disposing party under section 41(f)(3)(B) on these facts, so we should require an adjustment to the disposing party under section 936(j)(5)(D) under these facts. This interpretation fully regards the "similar rules" standard. Because section 41(f)(3)(B) does not contain a taxpayer requirement, applying section 936(j)(5)(D) without a taxpayer requirement is an application of rules similar to the rules in section 41(f)(3)(A) and (B), provided that such rules are consistent with the purpose of section 936(j).

Conversely, Taxpayer's interpretation of the rules of section 41(f)(3)(A) and (B) is incompatible with Congress' purpose for enacting section 936(j) and sound tax administration. By using the word "similar" in section 936(j)(5)(D), Congress intended to give the Service some flexibility in administering the adjusted base period income rules consistent with the plain language and purpose of the section 936 phase-out and termination provisions and, in particular, taking into account material differences between the section 41 and section 936(j) contexts. Therefore, even if Taxpayer's interpretation of section 41(f)(3)(A) and (B) were correct for purposes of section 41, those rules would need to be conformed to the section 936(j) context. Under either our interpretation or Taxpayer's interpretation of section 41(f)(3)(A) and (B), the result is that adjusted base period income follows a transferred major portion for purposes of section 936(j).

Taxpayer has proposed at least two theories to explain why a taxpayer requirement is necessary under section 41(f)(3)(B). Below, we summarize those two theories and explain why, even if they were correct, they support our interpretation of section 936(j)(5)(D).

Under one theory, Taxpayer claims that the taxpayer requirement is necessary to prevent whipsaw of the Government. In other words, if adjustments for a disposing party were permitted even though the acquiring party is not subject to tax, the Government could be whipsawed by virtue of the disposing party's increasing its credits while the acquiring party does not take on correspondingly greater potential tax exposure. As already noted, we have no reason to believe that the Government would consider such situation a whipsaw given that the encouraged activity is still occurring. So, as a threshold matter, we reject Taxpayer's premise that a taxpayer requirement is essential to the proper functioning of section 41(f)(3)(B). However, assuming arguendo that Taxpayer is correct about a potential whipsaw problem under section 41(f)(3) that is prevented by a taxpayer requirement, Taxpayer's argument actually supports our position. That is because, by importing a taxpayer requirement into section 936(j)(5)(D), we would be creating a potential whipsaw to the Government, not preventing one. In fact, that is Taxpayer's position in a nutshell. Taxpayer is asking us to interpret section 936(j)(5)(D) as creating a potential whipsaw whereby Taxpayer may separate section 936 credits from related business income by way of transferring a business offshore to a related company, thereby shifting future income offshore, while retaining onshore the adjusted base period income associated with that business.

Under a second theory, Taxpayer claims that the taxpayer requirement is intended under section 41(f)(3) to prevent qualified research expenses and gross income from "disappearing." We have no reason to believe that Congress had an anti-disappearance intent and, therefore, we do not accept Taxpayer's premise as a threshold matter. But assuming arguendo that Taxpayer is correct about this intent, this theory, like Taxpayer's whipsaw theory, actually supports our position.

Section 936(j) is a transition rule that applies during a phase-out period. The legislative history to section 936 indicates that Congress had concerns with the effectiveness of the section 936 credit since 1993. H.R. Rep. No. 111, 103d Cong., 1st Sess. 676 (1993). Despite Congress' attempts to limit the credit in 1993, it concluded in 1996 that the section 936 credit did not provide an appropriate incentive for investment and economic development in Puerto Rico. As a result, Congress enacted section 936(j), which repealed the section 936 credit for taxable years beginning after 1995 while allowing existing credit claimants that qualify for the section 936 credit to claim section 936 credits during a 10 year phase-out period. See H.R. Rep. No. 586, 104th Cong., 2d Sess. 131 (1996); S. Rep. No. 281, 104th Cong., 2d Sess. 109 (1996). But

Congress provided that, during part of the phase-out period, adjusted base period income would limit the amount of section 936 credit an existing credit claimant could claim. In discussing the computation of adjusted base period income, the report prepared by the Joint Committee on Taxation provides:

> Adjustments to the corporation's average adjusted base period possession business income to reflect acquisitions and dispositions shall be made under rules similar to the rules of section 41(f)(3). Under section 41(f)(3), adjustments are made upon the acquisition or disposition of the major portion of a trade or business or the major portion of a separate unit of a trade or business.

Joint Committee on Taxation Staff, General Explanation of Tax Legislation Enacted in the 104th Congress, 104th Cong., 210 (1996).

This background to section 936 indicates that a primary purpose for enacting section 936(j) was to gradually phase-out the section 936 credit with the methods provided by section 936(a)(4) and the application of the adjusted base period income provision followed by the termination of the section 936 credit. The purpose of the phase-out period was to provide "an appropriate transition period… for corporations that have existing operations in the possessions." H.R. Rep. No. 586, 104th Cong., 2d Sess. 131 (1996); see also S. Rep. No. 281, 104th Cong., 2d Sess. 109 (1996). In contrast, the section 41(f)(3)(A) and (B) provisions were enacted primarily to facilitate an accurate computation of base period expenditures and the credit by attributing research expenditures to the appropriate taxpayer." H.R. Rep. No. 201, 97th Cong., 1st Sess. 124-125 (1981).

So, turning back to Taxpayer's second theory, section 936(j) allows taxpayers to claim reduced section 936 credits for certain taxable years while those taxpayers arrange their affairs in anticipation of the ultimate expiration of section 936. The purpose of section 936(j) is to manage the gradual disappearance (to borrow Taxpayer's term) of the section 936 credit. The legislative history explicitly says that the reduced credit amounts allowed during the phase-out period would be subject to further reductions by way of adjustments under section 936(j)(5)(D). It strains credulity that, in this disappearing credit context, Congress' actual intent was to prohibit adjustments (rather than require them, as the legislative history and statutory plain language would seem to indicate) thereby allowing the continued claiming of undiminished credits by a party that has ceded its right to future income with respect to which the credit provision was created in the first place. In short, even if a taxpayer requirement serves an anti-disappearance function under section 41(f)(3)(B), such function is entirely inappropriate under section 936(j)(5)(D), which is a mechanism for making credits disappear when appropriate.

2. Response to Argument #2

a. Section 936(j)(5)(D) does not require that the acquiring party be an existing credit claimant in order for the disposing party to make adjustments

Taxpayer also claims that section 936(j)(5)(D) requires adjustments to the disposing party only if the acquiring party is an existing credit claimant. We see no support for this claim in the plain language of section 936(j)(5)(D) or any other provision of section 936(j) or 41(f)(3). Section 936(j)(9) defines the term "existing credit claimant," and section 936(j)(2) and (3) provide that an existing credit claimant may claim a section 936 credit in certain circumstances, but we see no provision that an acquiring party must be an existing credit claimant or that a disposing party need not adjust its adjusted base period income if the acquiring party is not an existing credit claimant. And Taxpayer brought no such provision to our attention. Such rules simply do not exist in section 936(j), and we can see no such analogous rule in section 41(f)(3)(B).

If anything, the plain language of section 936(j)(5)(D) illustrates that there is no requirement that the acquiring corporation be an existing credit claimant as a prerequisite to the disposing corporation adjusting its adjusted base period income. Pursuant to section 936(j)(9)(A)(ii), a corporation that is not an existing credit claimant can become an existing credit claimant by acquiring all the assets of a trade or business of a corporation among other requirements. In contrast, section 41(f)(3)(A) and, therefore, section 936(j)(5)(D) apply to parties that acquire only a major portion of a trade or business or a major portion of a separate unit of a trade or business. As Taxpayer itself has asserted, "all of the assets" of a trade or business is more than a "major portion" of the trade or business or a separate unit thereof. With that in mind, the category of acquiring parties (i.e., parties that acquire a "major portion") may be broader than the category of existing credit claimants (i.e., parties that, among other things, acquire "all the assets"). In short, the "all of the assets" standard in section 936(j)(9)(A)(ii) mandates that some acquiring parties are not existing credit claimants. Thus, section 936(j)(5)(D) can apply even if the acquiring corporation is not an existing credit claimant.

The General Explanation of the Joint Committee regarding section 936(j)(5)(D) supports our position. It refers only to making adjustments upon the acquisition or disposition of a major portion. It makes no reference to a requirement that the acquiring corporation be an existing credit claimant. The General Explanation indicates that Congress intended that adjusted base period income follow a transferred major portion regardless of the existing credit claimant status of the acquiring party. Such an interpretation of section 936(j)(5)(D) is the only interpretation consistent with the plain language and purpose of the phase-out and termination provisions of section 936(j).

b. Variation 1

As explained, the acquiring party's existing credit claimant status is irrelevant to this case. However, assuming arguendo that the acquiring party's status were relevant, Taxpayer's position would still be incorrect because FCorp is, based on the facts presented, an existing credit claimant. We walk through section 936 to explain our position.

We agree with Taxpayer that only an existing credit claimant may qualify to claim the section 936 credit during the phase-out period. Section 936(j)(1) provides generally that section 936 does not apply to taxable years beginning after December 31, 1995. But section 936(j)(3) provides that, in the case of an existing credit claimant,

> the credit under [section 936(a)(1)(A)] shall be allowed for the period beginning with the first taxable year after the last taxable year to which [section 936(j)(2)(A) or (B)], whichever is appropriate, applied and ending with the last taxable year beginning before January 1, 2006,

except that the aggregate amount of taxable income taken into account under section 936(a)(1)(A) shall not exceed the adjusted base period income of the existing credit claimant.

Section 936(j)(9)(A) defines "existing credit claimant." Section 936(j)(9)(A)(i) and (ii) provide that an existing credit claimant is a corporation that meets one of two tests. The parties agree that FCorp cannot satisfy the test set forth in section 936(j)(9)(A)(i). The test in section 936(j)(9)(A)(ii) requires that the corporation acquire all the assets of a trade or business of a corporation that was actively conducting the trade or business in a possession on October 13, 1995, and had a section 936 election in effect for its taxable year that included October 13, 1995. Section 936(a)(1)(A) provides that, if a domestic corporation elects application of section 936, and if the conditions of section 936(a)(2) are satisfied, then "there shall be allowed as a credit against the tax imposed by this chapter" a certain amount.

Taxpayer argues that, because only a domestic corporation may claim a credit under section 936(a)(1)(A), and because section 936(j)(3) allows existing credit claimants to claim the section 936(a)(1)(A) credit, the term "existing credit claimant" must refer only to domestic corporations. Taxpayer also argues that the words "existing credit claimant" imply that such party is permitted to claim the credit.

Taxpayer is incorrect on several independent grounds. First, the term "existing credit claimant" is unambiguously defined in section 936(j)(9). That definition refers only to "a corporation" and contains no mention of whether the corporation must be a domestic corporation or may be a foreign corporation. So Taxpayer's position contradicts the plain language of section 936(j)(9).

Second, defined terms have the meaning given to them in the definition, not the meaning that one might have expected the terms to have based on common usage or otherwise. In Xilinx Inc. and Cons. Subs. v. Commissioner, 567 F.3d 482, 491 n.9 (9th Cir. 2009), the Ninth Circuit Court of Appeals stated: "Congress and regulators may adopt a technical definition of a term that is distinct from its plain meaning." Thus, even if the plain meaning of the words "existing credit claimant" might suggest that such person is permitted to claim a credit and, thus, must be a domestic corporation, the technical definition provided by Congress for that term contains no domestic corporation requirement.[8]

Third, the interaction of section 936(a)(1)(A) and (j)(3) must be understood in the phase-out and termination context. Section 936(j)(1) provides that section 936(a)(1)(A) is generally inapplicable to taxable years beginning after 1995. However, section 936(j)(3) provides that, notwithstanding such general inapplicability, section 936(a)(1)(A) does apply to certain taxable years beginning after 1995. Specifically, section 936(j)(3) provides that the section 936(a)(1)(A) credit "is allowed for the period beginning with. . . and ending with the last taxable year beginning before January 1, 2006." Thus, section 936(j)(3) overrides the sunset of section 936(a)(1)(A) provided in section 936(j)(1). However, section 936(j)(3) does not override the substantive requirements in section 936(a)(1)(A). If section 936(a)(1)(A) applies to a taxable year by virtue of section 936(j)(3), an existing credit claimant must then determine whether it qualifies for a credit under section 936(a)(1)(A) during that taxable year in the first place. For that purpose, the existing credit claimant must, among other requirements, be a domestic corporation.[9] In short, being an existing credit claimant is merely a precondition to overriding the sunset of section 936(a)(1)(A). But once revived, section 936(a)(1)(A) will not allow a credit to an existing credit claimant that is not a domestic corporation. Therefore, although the foreign or domestic status of the acquiring corporation is relevant to the ultimate determination of whether the acquiring corporation may claim a credit under section 936(a)(1), foreign or domestic status is irrelevant to the threshold question of whether the acquiring corporation qualifies as an existing credit claimant for purposes of overriding section 936(j)(1) in the first place.

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[8] In this regard, Taxpayer makes an all too common mistake of statutory construction. We are reminded, for example, of the frequent misinterpretation of the controlled group provisions in section 1563 with respect to the meaning of "excluded member" as defined in section 1563(b)(2). Even experienced practitioners often assume mistakenly, based on the plain language of the term, that an "excluded member" is an entity that would have been a member of a controlled group under section 1563(a) but is excluded from the controlled group by virtue of section 1563(b)(2) when, in fact, an excluded member is explicitly defined as a member of the group.

[9] We note that the separateness of the existing credit claimant and domestic corporation concepts is echoed in the sister provision to section 936 – section 30A, which defines a qualified domestic corporation, in part, as a domestic corporation that is also an existing credit claimant.

c. Variation 2

As explained above, the acquiring party's existing credit claimant status is not relevant to this case. However, assuming arguendo that it were relevant, Taxpayer's position would still be incorrect because FCorp is, based on the facts presented, an existing credit claimant. Taxpayer asserted that it can easily demonstrate that FCorp did not acquire all the assets of a trade or business as required under section 936(j)(9)(A)(ii), but declined to present evidence in support of that claim. Accordingly, we think it is likely that the facts do not, in fact, support Taxpayer's claim. If Taxpayer does eventually present evidence with regard to this issue, we advise the Field to consult with the National Office regarding the proper interpretation of section 936(j)(9)(A)(ii). However, as noted more than once already, even if Taxpayer is able to demonstrate that FCorp is not an existing credit claimant because it did not acquire all the assets of a trade or business within the meaning of section 936(j)(9)(A)(ii), Taxpayer's Argument #2 would nonetheless fail because whether FCorp is an existing credit claimant is irrelevant to the resolution of the issue at hand.

3. Response to Argument #3

Taxpayer argues that, although section 41(f)(3)(B) itself draws the key distinction between a disposition of a major portion to a single acquirer, on the one hand, and a disposition of less than a major portion to any one party (or even a discontinuation of the major portion), on the other hand, we should understand the provision as supporting Taxpayer's position that it is appropriate to deny adjustments in cases involving a disposition of a major portion to a single acquirer. We see a number of reasons why Taxpayer gains no traction with those points. First, considering that the research credit is intended to encourage certain activities in the United States that, by their nature, are carried on within a major portion, it is entirely appropriate for adjustments to be denied to a person that discontinues a major portion in the United States, as opposed to a person that transfers it to another party that presumably intends to carry on that major portion in the United States. See I.R.C. § 41(d)(4)(F); Norwest Corp. and Subs. v. Commissioner, 110 T.C. 454, 485 (1998) ("The purpose of the credit was to 'stimulate a higher rate of capital formation and to increase productivity' [citations omitted], and to 'encourage business firms to perform the research necessary to increase the innovative qualities and efficiency of the U.S. economy' [citations omitted]."); Tax and Accounting Software Corp. v. United States, 111 F. Supp. 2d 1153, 1160 (N.D. Okla. 2000) ("the credit was established as an incentive to encourage taxpayers to incur the cost of research in developing new products and stimulating the economy."); Union Carbide Corp. and Subs. v. Commissioner, T.C. Memo 2009-50 ("Congress found research to be essential to America's economic progress and competitiveness [citation omitted]."); H.R. Rep. No. 201, 97th Cong., 1st Sess. 116 (1981) ("expenditures for research which is conducted outside the United States do not enter into the credit computation, whether or not the taxpayer is located or does business in the United States; the test is whether the laboratory experiments, etc. actually take place in this country.").

Second, the fact that adjustments are not required when the disposition involves less than a major portion is similarly inapposite. Section 41(f)(3)(B) draws a line based on the relative size of the disposition – presumably as a matter of administrability, to ensure the major portion is transferred as a functional unit, or both. For reasons that Congress did not make clear, it chose to apply the "major portion" standard, which focuses on transferring a viable business, not on the taxpayer status or existing credit claimant status of the acquiring corporation. H.R. Rep. No. 201, 97th Cong., 1st Sess. 125 (1981). A Congressional line-drawing decision to disallow adjustments if a disposition is too insignificant is simply irrelevant to this narrow legal issue, which is premised on the assumption by the parties that a major portion was transferred. As a matter of logic, it does not follow that, because adjustments are prohibited when research activities cease or when an insignificant disposition occurs, it is appropriate for adjustments to be denied when research activities have not ceased and the disposition of a unitary major portion occurs.

Finally, it is ironic that Taxpayer suggests that the reference to section 41(f)(3)(A) in section 41(f)(3)(B), which distinguishes between the transfer of an intact business and the disassembly or discontinuation of a business, should nonetheless be understood as denying adjustments to parties that have transferred intact businesses. To put it another way, the reason that things that are good for the goose are also good for the gander is that the goose and the gander are both geese – that is, they are materially similar. But in the present case, the factual scenarios that Taxpayer attempts to equate to one another in its Argument #3 are not all geese. They are materially dissimilar and, therefore, warrant different treatment – indeed, the very same different treatment that is ensured by the reference to section 41(f)(3)(A) in section 41(f)(3)(B).

4. Response to Argument #4

We see several problems with Argument #4. First, Taxpayer seems to argue that, because Treas. Reg. § 1.936-11(b)(3)(ii)(A) is an anti-abuse rule,[10] and because Taxpayer has not violated that rule, Taxpayer is shielded from examination or challenge regarding its interpretation and application of section 936(j)(5)(D). This argument is based on the false premise that we are imposing an "anti-abuse" application of section 936(j). On the contrary, we are merely interpreting and applying the language of the statute consistently with our best understanding of the underlying policy and intent. In short, the fact that a taxpayer has not committed an abuse anticipated by Congress does not mean that the taxpayer has correctly interpreted and applied the statute.

[10] We express no opinion as to whether Treas. Reg. § 1.936-11(b)(3)(ii)(A) was intended as an anti-abuse rule in response to the legislative history cited by Taxpayer.

Second, the preamble to Treas. Reg. § 1.936-11(b)(3)(ii)(A) explains that, if an acquiring party acquires all the assets relating to a pre-existing activity of an existing credit claimant, continues the activity in the possession, and makes a section 936(e) election, the acquiring party will be treated as an existing credit claimant. In other words, the regulation explains when an acquiring party (that was not otherwise an existing credit claimant) can qualify as an existing credit claimant. This concept (i.e., when can an acquiring party be an existing credit claimant?) is inapposite to the case at hand, which involves the issue of when a disposing party must make adjustments. As developed in the preceding analysis, the existing credit claimant status of the acquiring party has nothing to do with determining whether a disposing party must make adjustments.

Third, on the face of Treas. Reg. § 1.936-11(b)(3)(ii)(A), FCorp is, in fact, an existing credit claimant. That is, the regulation contradicts Taxpayer's claims that FCorp is not an existing credit claimant. As with the statute, the regulation contains no requirement that an existing credit claimant be a domestic corporation. On the contrary, FCorp qualifies as an existing credit claimant on the face of the regulation on which Taxpayer relies.

CAVEAT(S):

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.